

Economic Commentary

Medium Term Budget Policy Statement

Growth revised down and deficits higher, but a positive message on the composition and effectiveness of spending as well as on encouraging private sector investment and job creation

- A cautious statement against the background of a vulnerable global climate but with the right emphasis on investment, jobs and private sector participation in key sectors.
- Growth forecasts revised down as faltering developed economies hurt export growth.
- The budget deficit over the forecast period (2011/12 – 2014/15) rises from already high levels to 5,5% (from 5,3%), 5,2% (4,8%), 4,5% (3,8%) and 3,3%.
- Overall debt remains sustainable, but the Minister signals caution against borrowing in volatile markets.
- Emphasis on growth-enhancing spending and cutting out inefficiencies, extravagances and waste.
- Tax incentives for industrial investment, technology and training and incentives for industrial development zones.

Economic background and assumptions

The Medium-Term Budget Policy Statement (MTBPS) was presented against a backdrop of an uncertain global economic trajectory which has dimmed domestic growth prospects. South Africa faces substantial risks from the global economy. The global recovery has lost momentum, while European sovereign debt difficulties have escalated and threaten the stability of banking sectors in some of the countries.

The MTBPS emphasised the need to promote job creation, invest in public infrastructure as well as encourage private sector participation in key sectors. In an environment of moderate economic growth and still depressed revenue growth, the need for growth-enhancing government expenditure has risen. Accommodative monetary and expansionary fiscal policies are likely to support the economy in the coming years. Growth forecasts have been revised downwards, the budget deficit rises from already high levels and debt servicing has become the government's fastest growing expenditure item. Debt service costs are projected to reach R115 billion in 2014/15.

A less favourable global environment combined with a domestic slowdown, related partly to labour strikes in key production sectors, have prompted the National Treasury to revise its growth forecasts downwards. Economic growth is forecast at 3,1% in 2011, down from the February 2011 projection of 3,4%, but growth is projected to pick over the remainder of the Medium-Term Expenditure Framework (MTEF) period (2011/12 – 2014/15).

A key driver of growth will be household expenditure, but its growth rate will be limited by the still weak job market, consumer indebtedness and subdued growth in real consumer incomes. Fixed investment spending growth projections have been revised downwards, but will remain reasonable on the back of public sector investment.

Export growth will be subdued given the poor prospects in key trading partners, but is expected to pick up over the next two years, while the performance of imports is projected to remain relatively firm due to higher consumer expenditure and reasonable growth in fixed investment. The current account deficit is expected to be narrower than was projected in the February budget, while inflation is forecast to remain close to the 6% level over the forecast period.

Group Economic Unit

Isaac Matshego
+27 11 295 6451
IsaacMat@nedbank.co.za

Dennis Dykes
+27 11 295 6435
DennisD@nedbank.co.za

Corporate Place, 135 Rivonia Road,
Sandown, 2196, South Africa

<http://nedbankgroup.co.za>

Table 1 : Budget assumptions: initial and revised estimates for calendar years

	2010	2011		2012		2013		2014
%	Actual	Feb-11	Oct-11	Feb-11	Oct-11	Feb-11	Oct-11	Oct-11
Real gdp	2.8	3.4	3.1	4.1	3.4	4.4	4.1	4.3
Real gde	4.2	4.2	4.1	4.4	3.8	4.6	4.6	4.6
Real pce	4.4	4.2	4.3	4.3	3.7	4.5	4.4	4.5
Real gfcf	-3.7	3.9	2.9	5.5	4.5	6.8	5.7	6.3
Real gce	4.6	4.4	4.1	4.1	4.1	3.9	4.1	4.1
Exports	4.5	6.0	4.0	6.4	6.9	7.3	7.1	8.0
Imports	9.6	8.5	7.6	7.0	7.8	7.4	8.2	8.4
Current account to gdp	-2.8	-4.2	-3.4	-4.9	-3.8	-5.0	-4.0	-4.2
Gdp deflator	8.1	5.3	6.7	5.4	5.8	5.8	6.4	6.0
CPI	4.3	4.9	5.0	5.2	5.4	5.5	5.6	5.4

Source: National Treasury

The National Treasury's growth projections over the next three years are in line with our forecasts.

We forecast gdp growth of 3,1% in 2011, with growth picking up slightly to 3,5% in 2012 and 4,1% in 2013.

Table 2 : Budget assumptions: initial and revised estimates for fiscal years

	2010/11	2011/12		2012/13		2013/14		2014/15
	Actual	Feb-11	Oct-11	Feb-11	Oct-11	Feb-11	Oct-11	Oct-11
Gdp (R bn)	2,748.2	2,914.9	2,977.7	3,201.3	3,298.0	3,536.0	3,642.6	4,023.4
Real gdp (%)	3.3	3.6	2.8	4.2	3.8	4.4	4.1	4.3
Gdp inflation (%)	8.9	5.5	5.4	5.4	6.7	5.8	6.1	5.9
CPI (%)	3.8	4.8	5.4	5.3	5.2	5.5	5.6	5.4

Source: National Treasury

Fiscal policy and revised MTBPS

The Minister highlighted that the government has capacity to take on more debt, thereby benefitting from fiscal prudence during the boom years. However, he cautioned against any reckless accumulation of state debt as this would burden government finances in future.

Table 3 : Consolidated government fiscal framework

	2010/11	2011/12	2012/13	2013/14	2014/15
R billion	Actual	Estimate	Medium-term estimates		
Revenue	758.4	814.2	890.0	994.5	1,113.0
% rise		7.4%	9.3%	11.7%	11.9%
% of gdp	27.6%	27.3%	27.0%	27.3%	27.7%
Expenditure	885.8	978.8	1,062.3	1,157.4	1,247.0
% rise		10.5%	8.5%	9.0%	7.7%
% of gdp	32.2%	32.9%	32.2%	31.8%	31.0%
Budget balance	-127.4	-164.6	-172.3	-162.9	-134.1
% of gdp	-4.6%	-5.5%	-5.2%	-4.5%	-3.3%
Nominal gdp	2,748.2	2,977.7	3,298.0	3,642.6	4,023.4

Source: National Treasury

Revenue

Revenue growth remains subdued and has still not recovered to pre-recession levels. Tax in 2011/12 falls to R729 billion, which is R13 billion below the figure projected in the February 2011 budget. At a consolidated level, the revenue estimate for 2011/12 is revised down by R10,3 billion, with figures for 2012/13 and 2013/14 falling by the same amount each fiscal year.

As a percentage of gdp, revenue is projected to remain steady at around 27% over the MTEF period.

Expenditure

Greater moderation in government spending is planned for the next three years. In this fiscal year, consolidated government spending is now expected to increase by 10,5%, rising faster than the 9,1% target set in February's National Budget. Thereafter, the increase in consolidated expenditure is set to moderate to 7,7% by 2014/15, bringing expenditure as a percentage of gdp down to 31% from the current 32,9%. Over the forecast period, state debt costs will remain the fastest growing expenditure item in the budget, while real growth in non-interest expenditure will average just over 2%.

Government aims to change the composition of spending, away from immediate relief and consumption expenditure towards the longer-term aim of building a growing economy. Job creation and social services remain the key spending priorities. The MTBPS stresses the need to overcome and remove obstacles to accelerating the pace of public sector infrastructure spending. Health care also features strongly, with allocations made to pilot national health insurance in 10 districts. Education remains the biggest spending category and is set to increase at an annual average rate of 6,7% over the next three years. The focus will be on broadening access to education and improving school infrastructure.

The deficit and financing

The weaker growth outlook forces projected deficits higher over the current fiscal year as well as the three-year framework. The deficit for the current fiscal year rise to 5,5% of gdp from the 5,3% projected in the February 2011 budget, in line with the markets' and our own expectations. The deficit now falls below 4% in 2014/15 only. The local bond market will provide the bulk of the financing over the forecast period. The government will maintain a presence in international capital markets but will reduce its already limited foreign exposure.

Table 4 : Main budget net borrowing requirement and financing

	2010/11	2011/12		2012/13	2013/14	2014/15
R billion	Actual	Budget	Revised	Medium-term estimates		
Main budget balance¹	-135.9	-159.1	-169.5	-181.2	-175.6	-150.4
Extraordinary payments	-0.839	-0.150	-0.520	-	-	-
Extraordinary receipts	3.010	1.350	3.380	-	-	-
Financing requirement	-133.8	-157.9	-166.6	-181.2	-175.6	-150.4
Domestic short-term loans (net)	34.89	22.00	22.00	22.00	22.00	20.00
Domestic long-term loans (net)	136.9	135.4	135.1	134.9	131.3	113.2
Foreign loans (net)	2.839	4.999	-2.363	-1.835	-3.522	-0.422

Source: National Treasury

Other issues

The MTBPS again places a strong focus on job-creating growth. Encouragingly, Minister Gordhan stressed the need to enhance the competitiveness of the economy and to promote the type of structural change that will result in 'more rapid, inclusive growth'. There is also a welcome focus on encouraging greater private sector involvement in resolving some of the key obstacles to stronger economic growth. Consequently, government announced a 'competitiveness support package' of R25 billion over the next six years, mainly to boost industrial development, assist enterprises and accelerate job creation.

The package will include:

- Tax incentives for industrial investment, technology and training.
- Ongoing investment in energy, water, transport and communications infrastructure. Encouragingly, the MTBPS recognises the lack of sufficient infrastructure as one of the key stumbling blocks to unlocking higher investment, economic growth and employment in South Africa. The MTBPS mentions that while government will increase infrastructure spending, there will also be 'complementary reforms' to improve the quality of regulation and encourage increased private sector participation to improve efficiency and lower costs.
- Incentives to invest in industrial development zones
- Regulatory and administrative reform to support small businesses
- Continued support for black business development, including preferential procurement and finance facilities

- Encouraging export diversification, especially in seeking new markets in the fast growing emerging markets.
- The promotion of greater regional integration within sub-Saharan Africa, including investment in a north-south transport corridor and administrative reform of trade arrangements.
- Further support for job creation, mainly through speeding up infrastructure spending.
- Alignment of trade, investment and energy policies to support the transition to green energy. Government will also encourage private-sector participation in renewable energy production.

Apart from these incentives, Minister Gordhan also announced moves **to simplify and improve the investment framework**, including reforms to prudential and investment regulatory framework. National Treasury proposes that all inward listed shares on the JSE be classified as 'domestic' for the purposes of trading on the JSE, which should allow the JSE to attract new listings and boost investment in Africa. Added to this, government recommended the removal of ownership restrictions on international participation in foreign currency exchange bureaus and the current requirement for money remitters to partner with authorised dealers. The aim of these changes is to reduce the cost of cross-border remittances, particularly into other African countries. Finally, the Reserve Bank will also announce several measures that will reduce red-tape on cross-border transactions, simplify payment mechanisms and eliminate bias between resident and non-resident individuals.

Comment and Implications

The MTBPS should be well received by the markets and by major constituencies. The key messages were sound: an intention to bring the deficit under control and keep government debt from rising above an expected peak of 40% in 2015, changing the composition of government spending to help the economy grow, and encouraging the private sector to invest, create jobs and participate in key sectors that have so far been dominated by the state. Government's intention to cut out waste and extravagant spending and to improve the effectiveness of spending is particularly welcome and is backed up by the President's actions yesterday.

The challenge now will be to deliver on all these promises during a period of international economic and financial turmoil. Particularly important will be to stick to recurrent expenditure targets so that the chances of further increases in the deficit are reduced. South Africa's access to global markets has been good, but the current spotlight on public finances internationally has shown how important it is to maintain trust.

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